DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 02-0084
INDIVIDUAL INCOME TAX
For The Tax Periods: 1997 Through 1999

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ISSUE

I. **Individual Income Tax – Indiana Source Income**

Authority: IC 6-3-2-1, IC 6-8.1-5-1, IC 6-3-1-12, 45 IAC 3.1-1-22, Fla. Stat. § 199.052, Fla Stat. §222.17.

The Taxpayer protests the Department's adjustment to include dividends and interest in his adjusted gross income.

II. **Individual Income Tax – Entertainment Expenses**

Authority: IC 6-3-1-3.5, IRC § 212, IRC § 274, Treas. Reg §1.274-2, Treas. Reg §1.274-5A.

The Taxpayer protests the Department's adjustment disallowing an entertainment expense.

III. **Tax Administration – Penalty**

The Taxpayer protests the Department's assessment of a negligence penalty.

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2.

STATEMENT OF FACTS

Taxpayer and spouse filed joint Indiana individual income tax returns for the 1997, 1998, and 1999 calendar years. Taxpayer has filed form IT-40 PNR with the wife filing as an Indiana resident and the husband filing as a Florida resident. Taxpayer has excluded all income except in 1999 as being attributable to Florida. Taxpayer was audited for periods 1997 through 1999 and the auditor determined that all of husband's income was derived from Indiana sources. Taxpayer (husband) provided evidence of a Florida driver's license, voter registration, checking account and was selected for jury duty in Florida. Indiana BMV records indicate that husband's Indiana driver's license expired in August 1999. Taxpayers' residence is owned by a trust controlled by the wife and she claims the Indiana Homestead Credit on the Indiana property. Taxpayers

indicated on their 1997 through 1999 Indiana tax returns that two vehicles were registered in Indiana. Taxpayers used their Indiana address on their federal income tax return. A business building burned in 1998, destroying records for business and personal operations. More facts supplied as necessary.

I. **Individual Income Tax**: **Indiana Source Income**

DISCUSSION

Taxpayer was audited for Income tax for the periods of 1997 through 1999. Taxpayer has filed form IT-40 PNR with the wife filing as an Indiana resident and husband filing as a Florida resident. Taxpayer has excluded all income except in 1999 as being attributable to Florida. The auditor determined that all of husband's income was derived from Indiana sources.

Taxpayer claims that since he is a resident of Florida his interest and dividend income should not be subject to tax in Indiana. IC 6-3-2-1 states in part: "[e]ach taxable year, a tax at the rate of three and four-tenths percent (3.4%) of adjusted gross income is imposed upon the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every non-resident person." In order to determine whether all of Taxpayer's income or just the income derived from Indiana sources is subject to Indiana adjusted gross income tax, Taxpayer must show that he was not an Indiana resident. "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made". IC 6-8.1-5-1.

A resident is defined as any individual who is domiciled in Indiana during the taxable year or any individual who maintains a permanent place of residence and spends more then one hundred eighty-three (183) days within the state. IC 6-3-1-12.

45 IAC 3.1-1-22 defines domicile as follows:

> For the purposes of this Act, a person has only one domicile at a given time even though that person maintains more than one residence at that time. Once a domicile has been established, it remains until the conditions necessary for a change of domicile occur.
>
> In order to establish a new domicile, the person must be physically present at a place, and must have the simultaneous intent of establishing a home at that place. It is not necessary that the person intend to remain there until death; however, if the person, at the time of moving to the new location, has definite plans to leave that new location, then no new domicile has been established.
>
> The determination of a person's intent in relocating is necessarily a subjective determination. There is no one set of standards that will accurately indicate the person's intent in every relocation. The determination must be made on the facts

present in each individual case. Relevant facts in determining whether a new domicile has been established include, but are not limited to:

(1) Purchasing or renting residential property
(2) Registering to vote
(3) Seeking elective office
(4) Filing a resident state income tax return or complying with the homestead laws of a state
(5) Receiving public assistance
(6) Titling and registering a motor vehicle
(7) Preparing a new last will and testament which includes the state of domicile.

Taxpayer/husband has provided documentation showing that he is registered to vote and has been summoned to jury duty in Florida. Taxpayer also maintains a Florida driver's license and maintained a checking account in Florida. The husband canceled his Indiana voter's registration in 1996. Taxpayers own several acres of farm ground in Indiana and own several Indiana businesses. Taxpayers' residence is owned by a trust controlled by the wife and she claims the Indiana Homestead Credit on the Indiana property. However, Taxpayers indicated on their 1997 through 1999 Indiana tax returns that two vehicles were registered in Indiana. Also, according to records maintained by the Indiana Bureau of Motor Vehicles, the husband also maintained a valid Indiana driver's license that expired in August 1999 and registered a vehicle in Indiana in 2000. Taxpayers used their Indiana address on their federal income tax return.

While Taxpayer does not contend that the wife is a Florida resident, they claim that the husband is and that the couple spends much of their time in Florida. However, no documentation has been provided to show how much of each year is spent in Florida. Taxpayer conceded that a Florida Intangible Personal Property Tax Return was not filed as required by Fla. Stat. § 199.052. In addition. there is no evidence that husband filed a Declaration of Domicile in Florida pursuant to Fla Stat. §222.17.

Based on all the facts before the Department, Taxpayer has not demonstrated either a lack of an Indiana domicile or that he does not spend more then 183 days within the state of Indiana. Thus, all of Taxpayer's income should have been reported to Indiana.

FINDING

The Taxpayer's protest is respectfully denied.

II. Individual Income Tax – Entertainment Expenses

DISCUSSION

During the audit, the auditor made adjustments to Taxpayer's Sub-Chapter "S" distributions for disallowed advertising expenses. The expenses included Brickyard 400 and Indy Grand Prix race tickets.

The computation of Indiana Adjusted Gross Income for individuals begins with the definition provided in Section 62 of the Internal Revenue Code. IC 6-3-1-3.5. Taxpayer claims the expenses should be allowed pursuant to IRC § 212 which states in part: "[i]n the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year- (1) for the production or collection of income…."

However, Taxpayer does not consider IRC § 274(d) which states:

> Substantiation Required. – No deduction or credit shall be allowed-
> (1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home),
> (2) for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity,
> (3) for any expense for gifts, or
> (4) with respect to any listed property (as defined in section 280F(d)(4)),
>
> unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility or property, or the date and description of the gift, (C) the business purpose of the expense or the other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility or property, or receiving the gift. The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations. …

This is clarified in Treas. Reg §1.274-2 (1) which states in relevant part:

> Except as provided in this section, no deduction otherwise allowable under chapter 1 of the Code shall be allowed for any expenditure with respect to entertainment unless the taxpayer establishes-
> (i) That the expenditure was directly related to the active conduct of the taxpayer's trade or business, or
> (ii) In the case of an expenditure directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that the expenditure was associated with the active conduct of the taxpayer's trade or business….

Also Treas. Reg §1.274-2(c)(7) states:

> *Expenditures generally considered not directly related.* Expenditures for entertainment, even if connected with the taxpayer's trade or business, will generally be considered not directly related to the active conduct of the taxpayer's trade or business, if the entertainment occurred under circumstances where there

> was little or no possibility of engaging in the active conduct of trade or business. The following circumstances will generally be considered circumstances where there was little or no possibility of engaging in the active conduct of a trade or business:
> (i) The taxpayer was not present;
> (ii) The distractions were substantial, such as-
> (a) A meeting or discussion at night clubs, theaters, and sporting events, (*emphasis added*) or during essentially social gatherings such as cocktail parties....

Taxpayer has provided a list of the individuals who received the tickets. Yet, Taxpayer has not provided any documentation of what business took place either at or directly proceeding or following the races. Treas. Reg §1.274-5A(b)(1) states in part that:

> Section 274(d) and this section contemplate that no deduction shall be allowed for any expenditure for travel, entertainment, or a gift unless the taxpayer substantiates the following elements for each such expenditure:
>
> (i) Amount;
> (ii) Time and place of travel or entertainment (or use of a facility with respect to entertainment), or date and description of a gift:
> (iii) Business purpose; and
> (iv) Business relationship to the taxpayer of each person entertained, using an entertainment facility or receiving a gift.

Treas. Reg. §1.274-5A(c)(2) states:

> To meet the "adequate records" requirements of section 274(d), a taxpayer shall maintain an account book, diary, statement of expense or similar records provided in subdivision (ii) of this subparagraph) which, in combination, are sufficient to establish each element of an expenditure specified in paragraph (b) of this section. It is not necessary to record information in an account book, diary, statement of expense or similar record which duplicates information reflected on a receipt so long as such account book and receipt complement each other in an orderly manner.

Consequently, the auditor was correct in disallowing the expenditures. Taxpayer has not shown that any business took place.

FINDING

Taxpayer's request is respectfully denied.

IV. **Tax Administration – Penalty**

Taxpayer protests the ten percent negligence penalty. The Department may impose a ten percent (10%) negligence penalty on the amount of deficiency as determined by the Department. IC 6-8.1-10-2.1. Also, 45 IAC 15-11-2 states in part:

> …
> (a) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.
> (b) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
>
> Reasonable causes is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has not provided any reasonable caused to show that the penalty should be waived. Taxpayer's protest is respectfully denied.

FINDING

The Taxpayer's protest is respectfully denied.

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